

AR37

Prairie Oil Royalties

COMPANY, LTD.



ANNUAL REPORT

1980

Directors

- *Donald D. Barkwell** Calgary, Alberta
Senior Vice-President, Natural Resources
Norcen Energy Resources Limited
- *Edward A. Galvin** Calgary, Alberta
President
Poco Petroleum Ltd.
- Wilfrid A. Loucks** Calgary, Alberta
Vice-President, Minerals
Norcen Energy Resources Limited
- *Frederick A. McKinnon** Calgary, Alberta
Director of various companies
- Clifford A. Rae** Calgary, Alberta
Barrister & Solicitor
Macleod Dixon,
Barristers & Solicitors
- David M. Tyerman, Q.C.** Regina, Saskatchewan
Barrister & Solicitor
MacPherson, Leslie & Tyerman
Barristers & Solicitors

***Member of the Audit Committee**

Officers

- Donald D. Barkwell** *President*
Senior Vice-President, Natural Resources
Norcen Energy Resources Limited
- Peter Kaye** *Vice-President, Exploration*
Vice-President, Exploration
Norcen Energy Resources Limited
- William C. Hennenfent** *Vice-President, Production*
Vice-President, Production
Norcen Energy Resources Limited
- David M. Tyerman, Q.C.** *Secretary*
Barrister & Solicitor
MacPherson, Leslie & Tyerman
Barristers & Solicitors
- A. Kenneth Davies** *Treasurer*
Assistant Treasurer
Norcen Energy Resources Limited
- William T. Kilbourne** *Assistant Secretary*
Vice-President, Administration and Secretary
Norcen Energy Resources Limited
- Russell G. Rennie** *Assistant Secretary*
Assistant Secretary
Norcen Energy Resources Limited

DESCRIPTION OF BUSINESS

Prairie Oil Royalties Company, Ltd. was incorporated July 13, 1951 as a public company under the laws of the Province of Saskatchewan, Canada. The Company produces and sells crude oil, gas liquids and natural gas in Western Canada and is engaged in oil and gas exploration and development in Western Canada and the Canadian Arctic. The Company also holds interests in exploratory lands in the Yukon and Northwest Territories.

ANNUAL MEETING

The Annual Meeting of Shareholders of the Company will be held on Thursday, April 30, 1981 at 10:30 o'clock in the forenoon, local time, in the Board Room of Norcen Energy Resources Limited, 32nd Floor, 715-5th Ave. S.W., Calgary, Alberta, Canada T2P 2X7.

Executive Office

715-5th Avenue S.W., Calgary, Alberta T2P 2X7

Registered Office

2161 Scarth Street, Regina, Saskatchewan S4P 2V4

Auditors

Thorne Riddell, Calgary, Alberta

Registrars & Transfer Agents

Canada Permanent Trust Company,
Regina, Saskatchewan, and Toronto, Ontario

Morgan Guaranty Trust Company of New York,
New York, N.Y.

Stock Exchange Listings

Toronto Stock Exchange, Toronto, Ontario
American Stock Exchange, New York, N.Y.

Report to the Shareholders

Financial

Substantial gains in revenue, cash flow and net income were recorded in 1980. Revenue from all sources totalled \$7,501,000, an increase of \$1,335,000 or 22% over 1979 revenue, due entirely to higher prices received for the Company's production. Cash flow was \$6,496,000 or \$3.31 a share compared with \$5,183,000 or \$2.64 a share in 1979. Net income, at \$3,150,000 or \$1.61 a share, was \$903,000 higher than 1979 net income of \$2,247,000 or \$1.15 a share.

A more detailed financial analysis of the Company's operations for 1980 will be found on Page 13 of this Report.

Production

Average daily production for 1980 before deducting royalties was 787 barrels of oil and natural gas liquids and 9,169 Mcf of gas, compared to 800 barrels and 9,366 Mcf in 1979. The production of oil and gas liquids from West Pembina showed a further increase during 1980 but the increase was more than offset by production declines in older fields. Most of the decrease in natural gas production during 1980 was due to reduced exports to the United States of America where improvements in domestic supply have resulted from increased exploration activity and price de-regulation.

The price of Western Canadian crude oil increased \$1.00 a barrel on January 1, 1980 and \$2.00 a barrel on August 1, 1980. The average price received by the Company was \$14.62 a barrel, an increase of \$2.31 a barrel over the 1979 average price. Wellhead price increases on February 1 and September 1, 1980 and export price adjustments during the year raised the average price received for gas sold to \$2.13 an Mcf from \$1.64 an Mcf in the preceding year.

Reserves

Estimated reserves at December 31, 1980 before royalties were 2.96 million barrels of crude oil and natural gas liquids, unchanged from last year, and 66.7 billion cubic feet of natural gas compared to 70.3 billion cubic feet of natural gas at December 31, 1979. These estimates have been calculated by engineers of the parent company, Norcen Energy Resources Limited, and do not include the Company's share of natural gas reserves in the Arctic Islands. Further information on the Company's reserves appears in Note 5 to the financial statements

Outlook

The reduction in Canadian exports of natural gas to the United States and its effect on the Company's 1980 results has already been mentioned. This situation could continue for two or three years.

Two other events which will have an effect on the Company's growth and earnings in 1981 and beyond are the Federal Budget introduced on October 28, 1980 and the National Energy Program announced at the same time. Included in these measures was an 8% petroleum and natural gas revenue tax which came into effect on January 1, 1981. The National Energy Program has undergone some modification since its introduction and there are indications of further changes which may mitigate its impact on the industry and the Company. Therefore it is still too early to make an accurate assessment of the overall effect of these measures on the Company's operations.

On Behalf of the Board



Calgary Alberta
March 16, 1981

D. D. Barkwell
President

Exploration and Development

Taber-Chin Coulee

The Company is carrying out an active exploration program in the general Taber-Chin Coulee area of southern Alberta (see map) involving almost 100,000 acres, some of which were acquired during 1980. The Company's interests in these lands range from 4% to 27½%. A major drilling program planned for 1981 could result in the drilling of as many as twenty wells in this area. Some success has already resulted from the program but detailed information is being held confidential pending disposition of unleased lands in the immediate area.

Hoadley

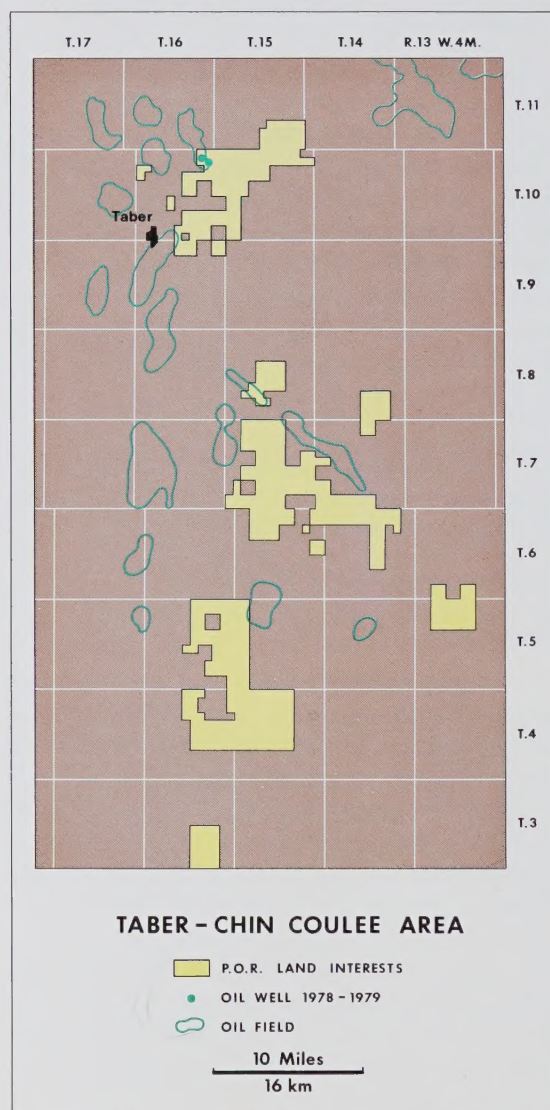
A further gas well was drilled at Hoadley in central Alberta during 1980. The Company now has a 7½% interest in four gas wells in this area. The latest well appears to have the greatest potential of the four wells drilled to date. Further drilling in the area is uncertain at the present time due to the lack of gas markets.

Big Bend-Athabasca

The Company participated in the drilling of four gas completions from the Cretaceous Sands in the general Big Bend-Athabasca area located 100 miles north of the city of Edmonton. Two of these wells are located in the Rourke-Chisholm section of the area where the Company has a 12½% interest. The other two are located in the Athabasca section where the Company's interest is 37½%.

Thunder

This area is located in central Alberta, approximately 25 miles northwest of Glenevis. Early in 1980 the Company participated to the extent of a 5% interest in the purchase of a petroleum and natural gas license on



which two wells have been drilled. The first well resulted in a multi-zone gas and oil well. The second well, an offset to the first well, was drilled one mile to the west and also was completed as a gas and oil discovery. Further drilling is planned for the immediate future.

Brewster Creek

At Brewster Creek in the Deep Basin area of western Alberta, the Company parti-

cipated to the extent of a 12.5% interest in an 11,000 foot Mississippian test completed as an Elkton gas well. Further drilling in this area has not been finalized due to lack of gas markets.

Minnehik

In the Minnehik area of central Alberta, the Company participated to the extent of a 5% interest in an Ostracod Sand oil completion. This well is producing at the rate of 160 barrels of oil a day. A one mile offset to this discovery has been drilled and is awaiting production testing. The Company has participated also in two land acquisitions in the immediate area. Considerable drilling activity is anticipated in this area during 1981.

Arctic Islands

There has been no activity on the Company's holdings in the Arctic Islands since 1978 apart from a 148 mile onshore seismic program completed on the Sabine Peninsula in 1980 to investigate deeper zones. A 121 mile seismic program is to be conducted over the Company's holdings during 1981.

West Pembina

Pressure maintenance by natural gas injection has commenced in the Brazeau River Nisku 'A' Pool and will be initiated in the WestPem Nisku 'D' Pool early in 1981. A waterflood scheme is underway in the WestPem Nisku 'C' Pool. In the Nisku 'E' Pool, facilities are in place for the production of natural gas and condensate and for the reinjection of natural gas commencing in early 1981. The Company has a 1.75% interest in the Brazeau River pool and 5% in the other three pools.

These enhanced recovery projects are expected to triple the Company's total share of production from the West Pembina field to over 300 barrels a day of oil and condensate

by the end of 1981. However, production cut-backs by the Province of Alberta pending settlement of the energy dispute with the federal government may reduce this level by about one-third while they are in effect.

Athabasca

Recent exploratory activity in this area has resulted in the addition of natural gas reserves of approximately 4.5 billion cubic feet to the Company's gas sales contract for the area. The recent gas completions in this area will be tied-in to the field gathering system and placed on production during the first half of 1981.



Drilling Summary

During 1980 the Company participated in the drilling of 54 (7.48 net) wells resulting in 5 (.29 net) oil wells and 29 (4.36 net) gas wells. The following table sets forth the gross and net exploratory and development wells in which the Company participated during the five year period ended December 31, 1980.

Year	Exploratory Wells				Development Wells			
	Gross Wells	Net Wells			Gross Wells	Net Wells		
		Oil	Gas	Dry Holes		Oil	Gas	Dry Holes
1976	23	.04	1.06	3.38	29	.47	5.12	1.05
1977	20	.42	1.17	3.21	31	.50	7.58	.56
1978	31	.48	1.53	4.91	6	—	.54	—
1979	31	.47	2.34	2.19	19	.05	4.03	—
1980	40	.29	2.19	2.83	14	—	2.17	—
	<u>145</u>	<u>1.70</u>	<u>8.29</u>	<u>16.52</u>	<u>99</u>	<u>1.02</u>	<u>19.44</u>	<u>1.61</u>

As at December 31, 1980 the Company had interests in 851 gross (51 net) producing oil and gas wells.

Oil and Gas Landholdings

At December 31, 1980 the Company owned interests in 3,525,014 gross (334,014) net acres compared to 4,009,561 gross (344,300 net) at the end of 1979. These landholdings include 400,677 gross (55,977 net) producing acres and are shown in detail in the following summary:

	Leases		Reservation & Permits		Total	
	Gross Acres	Net Acres	Gross Acres	Net Acres	Gross Acres	Net Acres
British Columbia	124,127	6,808	8,371	288	132,498	7,096
Alberta	874,913	163,273	196,160	20,982	1,071,073	184,255
Saskatchewan	89,783	34,153	—	—	89,783	34,153
Manitoba	72,642	20,929	—	—	72,642	20,929
Ontario	3,743	776	—	—	3,743	776
Arctic Islands	102,630	3,232	2,013,305	81,900	2,115,935	85,132
Northwest Territories	39,340	1,673	—	—	39,340	1,673
	<u>1,307,178</u>	<u>230,844</u>	<u>2,217,836</u>	<u>103,170</u>	<u>3,525,014</u>	<u>334,014</u>

In addition to the above, royalty interests are held in 216,701 acres.

Financial Statements

years ended December 31, 1980, 1979 and 1978

Accounting Policies

The Annual Report and the accompanying financial statements have been prepared by Management and approved by the Board of Directors. The financial statements have been prepared in accordance with generally accepted accounting principles applied on a consistent basis and comply with United States disclosure requirements. Additional disclosures are included in the notes to the financial statements to comply with recent amendments to the United States Securities and Exchange Commission rules and regulations. The amounts contained in this report are in Canadian dollars unless otherwise stated. The principles used were those judged by Management to be the most appropriate in the circumstances. Management acknowledges responsibility for the fairness, integrity and objectivity of all financial information contained in the Annual Report including the financial statements.

Properties, plant and equipment

Oil and gas properties, in accordance with the full cost method of accounting, include all expenditures related to the exploration and development of oil and gas reserves, whether or not potentially productive, together with the excess of acquisition cost over underlying value of net assets at date of purchase. These costs are depleted on the composite unit of production method based on total estimated proven recoverable reserves.

Oil and gas production equipment and related facilities are depreciated over their estimated useful service life on the straight-line method at various rates, the application of which is equivalent to a composite rate of approximately 8.3% (7.8% in 1979, 7.3% in 1978).

Proceeds on sale of non-producing properties are credited to asset costs.

Maintenance and repairs are charged to income when incurred and betterments which extend the serviceable life of properties are capitalized.

Income Taxes

The Company follows the tax allocation method of accounting whereby provisions for income taxes are based on the income reported in the accounts. This method results in the provision of deferred income taxes to the extent that taxes currently payable have been reduced by claiming depletion and depreciation for income tax purposes in amounts differing from those reported in the accounts.

Deferred gas revenues

Amounts received for annual contracted gas volumes not taken by pipeline purchasers are deferred and will be recognized as revenue when deliveries are made or upon expiry of the period allowed for such deliveries. Amounts received in prior years have been reclassified from current liabilities.

BALANCE SHEET

as at December 31, 1980 and 1979
(thousands of dollars)

Assets

CURRENT ASSETS

Accounts receivable	\$ 1,946	\$ 1,752
Income taxes recoverable	648	466
Drilling and other deposits	43	58

2,637

2,276

PROPERTIES, PLANT AND EQUIPMENT (note 2)	33,620	28,075
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\$36,257

\$30,351

Liabilities

CURRENT LIABILITIES

Bank indebtedness	\$ 27	\$ 464
Bank loan, unsecured	2,585	3,420
Accounts payable and accrued liabilities	1,838	676
Due to parent company	405	190

4,855

4,750

DEFERRED GAS REVENUES	1,541	246
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DEFERRED INCOME TAXES	6,971	5,615
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Shareholders' Equity

CAPITAL STOCK

Issued 1,961,520 Common Shares	1,962	1,962
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CONTRIBUTED SURPLUS	574	574
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RETAINED EARNINGS	20,354	17,204
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22,890

19,740

\$36,257

\$30,351

Approved by the Board

D. D. Barkwell, Director

W. A. Loucks, Director

STATEMENT OF INCOME

years ended December 31, 1980, 1979 and 1978
(thousands of dollars except per share amounts)

	<u>1980</u>	<u>1979</u>	<u>1978</u>
REVENUE			
Oil and gas sales	\$5,983	\$4,695	\$2,720
Royalties	1,501	1,322	930
Interest	<u>17</u>	<u>149</u>	<u>675</u>
	<u>7,501</u>	<u>6,166</u>	<u>4,325</u>
EXPENSES			
Production	785	592	421
Depletion	1,648	1,453	556
Depreciation	343	262	171
General and administrative			
Charges from parent company	510	389	145
Other	46	62	58
Interest	<u>334</u>	<u>395</u>	<u>13</u>
	<u>3,666</u>	<u>3,153</u>	<u>1,364</u>
Income before income taxes	<u>3,835</u>	<u>3,013</u>	<u>2,961</u>
Income taxes (note 3)			
Current (recovery)	(671)	(454)	(424)
Deferred	<u>1,356</u>	<u>1,220</u>	<u>1,226</u>
	<u>685</u>	<u>766</u>	<u>802</u>
NET INCOME	<u>\$3,150</u>	<u>\$2,247</u>	<u>\$2,159</u>
NET INCOME PER SHARE	<u>\$1.61</u>	<u>\$1.15</u>	<u>\$1.10</u>

STATEMENT OF RETAINED EARNINGS

years ended December 31, 1980, 1979 and 1978
(thousands of dollars)

	<u>1980</u>	<u>1979</u>	<u>1978</u>
BALANCE AT BEGINNING OF YEAR	\$17,204	\$14,957	\$12,798
Net income	<u>3,150</u>	<u>2,247</u>	<u>2,159</u>
BALANCE AT END OF YEAR	<u>\$20,354</u>	<u>\$17,204</u>	<u>14,957</u>

STATEMENT OF CHANGES IN FINANCIAL POSITION

years ended December 31, 1980, 1979 and 1978
(thousands of dollars)

	1980	1979	1978
SOURCE OF FUNDS			
Operations	\$ 6,496	\$ 5,183	\$ 4,112
Increase in deferred gas revenues	1,296	48	198
	7,792	5,231	4,310
APPLICATION OF FUNDS			
Properties, plant and equipment	7,536	13,374	7,063
INCREASE (DECREASE) IN FUNDS	<u>\$ 256</u>	<u>\$(8,143)</u>	<u>\$(2,753)</u>
CHANGES IN COMPONENTS OF FUNDS ARE REPRESENTED BY:			
Cash and deposits	\$ —	\$(4,785)	\$(3,740)
Accounts receivable	194	790	280
Income taxes recoverable	182	(245)	614
Drilling and other deposits	(15)	(12)	18
Bank indebtedness	437	(464)	—
Bank loan, unsecured	835	(3,420)	—
Accounts payable and accrued liabilities	(1,162)	68	10
Due to parent company	(215)	(75)	65
INCREASE (DECREASE) IN FUNDS	<u>\$ 256</u>	<u>\$(8,143)</u>	<u>\$(2,753)</u>

Auditors' Report

TO THE SHAREHOLDERS OF
PRAIRIE OIL ROYALTIES COMPANY, LTD.

We have examined the balance sheet of Prairie Oil Royalties Company, Ltd. as at December 31, 1980 and 1979 and the statements of income, retained earnings and changes in financial position for each of the three years ended December 31, 1980. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at December 31, 1980 and 1979 and the results of its operations and the changes in its financial position for each of the three years ended December 31, 1980 in accordance with generally accepted accounting principles applied on a consistent basis.

Calgary, Canada
February 3, 1981

THORNE RIDDELL
Chartered Accountants

Notes to Financial Statements

years ended December 31, 1980, 1979 and 1978

(thousands of dollars except per share amounts or unless otherwise stated)

1. ACCOUNTING POLICIES

The information on page 5 presents a summary of the principal accounting policies and is an integral part of these financial statements.

2. EXPLORATION AND PRODUCTION ACTIVITIES

The Company has capitalized costs in oil and gas activities as follows:

	Year ended December 31,	
	1980	1979
Properties	\$35,797	\$29,982
Production equipment	5,856	4,135
	<u>41,653</u>	<u>34,117</u>
Accumulated depreciation, depletion and amortization	8,033	6,042
Capitalized costs	<u>\$33,620</u>	<u>\$28,075</u>

The following table presents information on the Company's oil and gas producing activities:

	1980	1979	1978
Costs capitalized in the year			
Property acquisition	\$1,350	\$ 9,189	\$2,842
Exploration	3,361	3,002	3,025
Development	2,825	1,183	1,196
Total capitalized	<u>\$7,536</u>	<u>\$13,374</u>	<u>\$7,063</u>

Included in the above are exploration overhead costs of \$292 during 1980, \$299 during 1979 and \$290 during 1978 charged by the parent company.

Depreciation, depletion and amortization expense ...	<u>\$1,991</u>	<u>\$ 1,715</u>	<u>\$ 727</u>
Net revenues from producing oil and gas			
Revenue	\$7,484	\$ 6,017	\$3,650
Production expenses	<u>785</u>	<u>592</u>	<u>421</u>
Net revenue	<u>\$6,699</u>	<u>\$ 5,425</u>	<u>\$3,229</u>

3. INCOME TAXES

Deferred income taxes result from timing differences in the recognition of income and expenses for income tax and financial statement purposes. The source of these differences and the tax effect of each are as follows:

	1980	1979	1978
Exploration and development expenditures and capital cost allowances deducted for income tax purposes in excess of depletion and depreciation ...	\$1,706	\$1,379	\$1,276
Other Items	<u>(350)</u>	<u>(159)</u>	<u>(50)</u>
	<u>\$1,356</u>	<u>\$1,220</u>	<u>\$1,226</u>

The provision for income taxes in the statement of income reflects effective tax rates of 17.9% in 1980, 25.4% in 1979 and 27.1% in 1978 on income before income taxes, which are lower than the Canadian federal statutory rate of 46%. Such income tax expense varies from the amounts that would be computed by applying the rate of 46% to income before income taxes for the following reasons.

	<u>1980</u>		<u>1979</u>		<u>1978</u>	
		<u>% of pretax income</u>		<u>% of pretax income</u>		<u>% of pretax income</u>
Computed income tax expense	\$1,764	46.0	\$1,386	46.0	\$1,362	46.0
Increase (Decrease) in income taxes resulting from:						
Income tax depletion	(744)	(19.4)	(460)	(15.3)	(329)	(11.1)
Non-deductible royalties, mineral taxes and other expense, less federal resource allowance and provincial rebates	(220)	(5.7)	(213)	(7.1)	(180)	(6.1)
Other, net	(115)	(3.0)	53	1.8	(51)	(1.7)
Actual income tax expense	<u>\$ 685</u>	<u>17.9</u>	<u>\$ 766</u>	<u>25.4</u>	<u>\$ 802</u>	<u>27.1</u>

4. QUARTERLY AND OTHER FINANCIAL DATA (UNAUDITED)

	<u>Quarter</u>				<u>Year</u>
	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>	
<u>1980</u>					
Sales and other revenue	\$2,234	\$1,867	\$1,510	\$1,890	\$7,501
Income before income taxes	1,215	1,111	783	726	3,835
Net income	867	818	742	723	3,150
Net income per common share	0.44	0.42	0.38	0.37	1.61
Market price per common share (i)					
High	30¾	25¾	28¾	27	30¾
Low	15¾	17½	22	14	14
<u>1979</u>					
Sales and other revenue					
as previously reported	\$1,439	\$1,101	\$1,170	\$2,456	\$6,166
as restated (ii)	1,611	1,276	1,348	1,931	6,166
Income before income taxes					
as previously reported	867	449	382	1,315	3,013
as restated (ii)	972	546	588	907	3,013
Net income					
as previously reported	602	367	332	946	2,247
as restated (ii)	725	407	455	660	2,247
Net income per common share					
as previously reported	0.31	0.19	0.17	0.48	1.15
as restated (ii)	0.37	0.21	0.23	0.34	1.15
Market price per common share (i)					
High	17¾	22	21¾	26¼	26¼
Low	13¾	15¾	16¾	18	13¾

(i) The market prices are as reported by the American Stock Exchange, the primary market, in U.S. dollars.

(ii) Reflects adjustments to previously reported revenue and operating expenses relating to oil and gas operations.

5. SUMMARY OF OIL AND GAS PRODUCING ACTIVITIES (UNAUDITED)

Reserves as determined by company engineers are stated on page 1 of this report on a before royalty basis and include proven remaining reserves together with probable additional reserves reduced by a risk factor, all in accordance with Canadian practice.

The following information is provided in response to United States reporting requirements for which purpose information is to be provided on a proven reserve basis only after deducting royalty interest of others. Since all of the Company's proven reserves are developed, such information is provided only for proven developed reserves.

The following table summarizes the changes in quantities of net proven oil and gas reserves as determined by independent reservoir engineers (McDaniel and Associates Consultants Ltd.). Such quantities vary from the reserves determined by company engineers as reported on page 1 of this report, due to judgmental and timing differences in making reserve estimates.

	Year ended December 31,					
	1980		1979		1978	
	Oil & gas liquids	Gas	Oil & gas liquids	Gas	Oil & gas liquids	Gas
	(000's bbls)	(Mmcf)	(000's bbls)	(Mmcf)	(000's bbls)	(Mmcf)
Beginning of year	1,759	36,848	1,284	34,243	1,201	19,821
Revisions of previous estimates	273	313	339	1,826	(135)	3,529
Purchase of reserves in place	—	—	—	—	98	10,334
Extensions, discoveries and other additions	—	3,984	328	3,012	242	2,051
Production	(199)	(2,145)	(192)	(2,233)	(122)	(1,492)
End of Year	<u>1,833</u>	<u>39,000</u>	<u>1,759</u>	<u>36,848</u>	<u>1,284</u>	<u>34,243</u>

6. RESERVE RECOGNITION ACCOUNTING (UNAUDITED)

The following information summarizes the oil and gas producing activities for the years indicated on the basis of the reserve recognition method of accounting as prescribed by the United States Securities and Exchange Commission ("SEC"). The SEC requires that reserve recognition accounting ("RRA") be presented as a supplement to the cost methods historically followed by oil and gas producing companies. The Company believes that RRA statements generally do not accurately reflect the economic value of oil and gas reserves or the income to be derived therefrom.

RRA attempts to (i) assign a value to proven reserves which is more indicative of the value of the reserves than cost, (ii) reflect additions to proven reserves and changes in valuation of proven reserves in the income statement and (iii) expense all costs of finding and developing additions to proven reserves, including all costs determined to be not productive, during the current period. In order to develop the values for inclusion in the balance sheet and the additions to proven reserves on the income statement, several assumptions are made. The present value information is calculated by applying a per annum discount rate of 10% as stipulated by the SEC to the estimated net proven reserves shown above. Income taxes have been calculated on the taxes payable basis by applying rates and other statutory provisions currently in effect.

The basis for the amounts presented includes projected production schedules, forecasted development and production costs, and estimates of reserve quantities. Because of the uncertainty inherent in any projections of the future, actual production volumes and development costs may vary from those utilized to calculate the present value of estimated future net

revenues. Further, to the extent that the actual cost of capital is different from the prescribed discount rate of 10%, the value of the reserves, as shown below, will be different.

In calculating the estimated future net revenues before income taxes at the end of 1980, prices and costs in effect at January 1, 1981 were assumed to continue for all future periods and provision was made for estimated future development expenditures that will be required to produce the reserves. However, draft provisions of the National Energy Program have not been reflected in this calculation.

The estimated future net revenues before income taxes as at December 31, 1980 expected to be earned in each of the three years subsequent to 1980 and in total for all future years are as follows:

1981	1982	1983	Thereafter	Total
(millions)				
\$5.2	\$6.1	\$6.0	\$75.6	\$92.9

The present value of estimated future net revenues discounted at 10% based on estimated reserves at the end of each year, calculated on the basis outlined above, is as follows:

1980	1979	1978
(millions)		
\$44.5	\$37.5	\$27.1

The following table summarizes the oil and gas producing activities for the years indicated on the basis of RRA and was prepared under the assumptions stated above for proven developed reserves. RRA is based on the recognition of revenue at the time that proven reserves are determined. The summary of oil and gas producing activities on the basis of RRA sets out the present value (discounted at 10% per annum) of the future net revenues expected to be derived at current price and cost levels from the current year's exploration activities and evaluation of proven reserves.

	Year ended December 31,	
	1980	1979
	(millions)	
Additions and revisions to estimated proven reserves, net of royalties		
Additions to estimated proven reserves	\$ 2.0	\$ 4.9
Revisions to estimates of proven reserves in prior years		
Changes in prices	7.4	6.1
Other	.5	2.1
Accretion of discount	3.7	2.7
	13.6	15.8
Acquisition, exploration, development and production costs (i)	5.7	4.5
Additions and revisions to proven reserves over evaluated costs (ii)	7.9	11.3
Provision for income taxes (ii)	2.4	4.8
Results of oil and gas producing activities on the basis of RRA (ii)	<u>\$ 5.5</u>	<u>\$ 6.5</u>

(i) Property acquisition and exploration costs aggregating \$1.1 million to December 31, 1980 have not been included in the summary pending the determination of proven reserves.

(ii) The effect of incorporating the Petroleum and Gas Revenue Tax recently introduced in the National Energy Program would have been to reduce "Additions and revisions to proven reserves over evaluated costs" by \$5.4 million. Similarly the provision for income taxes would increase by \$0.08 million due to the loss of the earned depletion allowance on development expenditures.

The primary financial statements shown elsewhere herein recognize revenue upon the production and sale of the Company's reserves. For 1980 the profit contribution from the production and sale of oil and gas, before administrative expenses, interest and taxes, reflected in the primary financial statements is \$4.7 million (1979 - \$3.7 million).

The following table which was prepared using the assumptions stated above summarizes the changes in the present value of estimated future net revenues from proven reserves.

	Year ended December 31,	
	1980	1979
	(millions)	
Increase		
Net additions and revisions	\$13.6	\$15.8
Previously projected development costs	0.1	—
	13.7	15.8
Decrease		
Sales of oil and gas and value of transfers (net of production costs of \$0.8 and \$0.6 respectively)	6.7	5.4
Net increase	7.0	10.4
Beginning of year	37.5	27.1
End of Year	<u>\$44.5</u>	<u>\$37.5</u>

The present value of the estimated future net revenues from proven reserves as of the end of the year should not be viewed as the amount which might be realized in a sale of the reserves in place, nor as the amount which will be ultimately realized from production from the properties.

Management's Discussion and Financial Review

Revenue and Expenses

Net income increased in 1980 to \$1.61 per share from \$1.15 per share in 1979 and \$1.10 per share in 1978. Return on average common share equity was 14.8% in 1980 compared with 12.1% in 1979 and 13.2% in 1978. Funds provided from operations increased 25.4% over 1979. Comparatively 1979 was 26% over 1978.

1980 Compared to 1979

Sales and other revenues increased 22% above the 1979 level. The increase in oil and gas revenues primarily reflects price increases of \$1 per barrel of crude oil on January 1 and \$2 per barrel on August 1, 1980 and related increases of 15¢ per Mcf on natural gas on February 1 and 30¢ per Mcf on September 1, 1980.

Expenses, exclusive of income taxes, increased \$513,000 or 16%. Production expenses continued to rise due to inflationary pressures and higher costs to maintain producibility in existing fields. The increase in depreciation and depletion results from increased capital expenditures in the last few years and the full year effect of the Shenandoah acquisition of 1979. The depletion rate per equivalent barrel increased to \$1.95 from \$1.69. General and administrative expenses are up due to higher management fees paid to Norcen Energy Resources Limited under the terms of the management contract. Interest expense decreased by 15% as a result of lower short-term borrowings which was partially offset by higher average interest rates.

Income taxes decreased as explained in detail in Note 3 to the Financial Statements.

1979 Compared to 1978

Total revenue increased 43% over 1978. An increase in oil and gas revenues was offset by a reduction in interest income. The increase in oil and gas revenues reflects substantial increases in production of oil and gas together with higher prices at the wellhead and lower royalty rates. The increase in oil production came primarily from the development of the West Pembina area while the gas production increase was attributable to new property interests acquired from the Shenandoah Oil Corporation early in 1979 in the Verger and Netook areas of Alberta and the Yoyo, Jeans-Fireweed and Inga areas of British Columbia. The price of crude oil increased by \$1.00 a barrel on July 1, 1979 and natural gas prices increased proportionately. Gas royalty rates decreased with the addition of the new property interests mentioned above.

Interest income was reduced by \$526,000 and interest expense increased due to the acquisition of the Shenandoah properties.

Production, depletion and depreciation expenses all increased due to the new properties from the acquisition. The depletion rate increased to \$1.69 per equivalent barrel from \$0.87 in 1978. Administrative expenses are up mainly on account of increased management fees paid to Norcen Energy Resources Limited under the terms of the management contract.

Current and deferred income taxes have declined in spite of increased earnings before income taxes due to higher income tax depletion and federal resource allowance deductions. An analysis of the effective tax rate is discussed in detail in Note 3 to the Financial Statements.

Balance Sheet

The total assets of the company have continued to grow to \$36.3 million from \$30.4 million in 1979 and \$22.9 million in 1978. This growth is attributable to the significant capital expenditures program amounting to \$7.5 million, \$13.4 million and \$7.1 million in the last three years.

Short-term Debt

Short-term debt outstanding has declined during the past year from \$4.1 million in 1979 to \$3.0 million in 1980. The 1979 short-term borrowings increased due to the additional financing required for the purchase of Shenandoah.

Financial Position

The funds position of the company increased \$.3 million in 1980 and decreased \$8.2 million in 1979 compared to a \$3.0 million decrease in 1978. While annual generation of funds from operations increased steadily over the period, the increase was more than offset by greatly increased annual capital expenditures.

SELECTED FINANCIAL DATA

FOR THE YEARS ENDED December 31

Revenue (\$000)			1980		1979		1978		1977		1976	
Oil sales			\$ 1,520		\$1,079		\$ 529		\$ 378		\$ 312	
Gas sales			4,463		3,616		2,191		1,370		1,050	
Royalties			1,501		1,322		930		983		688	
Interest & Other			17		149		675		710		446	
			7,501		6,166		4,325		3,441		2,496	
Expenses (\$000)												
Production			\$ 785		\$ 592		\$ 421		\$ 321		\$ 201	
Depletion			1,648		1,453		556		364		294	
Depreciation			343		262		171		188		39	
General and administrative			556		451		203		75		135	
Interest			334		395		13		—		—	
			3,666		3,153		1,364		948		669	
Income before Income Taxes (\$000)			\$ 3,835		\$ 3,013		\$2,961		\$2,493		\$1,827	
Income Taxes (\$000)												
Current (recovery)			\$ (671)		(454)		(424)		232		147	
Deferred			1,356		1,220		1,226		509		434	
			685		766		802		741		581	
Income before extraordinary item (\$000)			3,150		2,247		2,159		1,752		1,246	
Extraordinary item			—		—		—		—		4,294	
Net Income (\$000)			\$ 3,150		\$ 2,247		\$2,159		\$1,752		\$5,540	
Net Income Per Share												
Before extraordinary item			\$1.61		\$1.15		\$1.10		\$0.89		\$0.63	
After extraordinary item			\$1.61		\$1.15		\$1.10		\$0.89		\$2.82	
Cash Flow before extraordinary item (\$000)			\$ 6,496		\$ 5,183		\$4,112		\$2,700		\$2,013	
Expenditures (\$000)												
Exploration and property acquisitions			\$ 5,815		\$12,607		\$6,047		\$2,099		\$1,282	
Plant and equipment (net after sales)			\$ 1,721		\$ 767		\$1,016		\$1,061		\$ 477	
Shares issued and outstanding (i)			1,961,520		1,961,520		1,961,520		1,961,520		1,961,520	
Total Assets (\$000)			\$36,257		\$30,351		\$22,943		\$19,435		\$17,550	
Market Price Ranges of Shares (U.S.\$)			High	Low	High	Low	High	Low	High	Low	High	Low
American Stock Exchange 1st Quarter			30¾	15¾	17⅞	13⅞	19⅞	13⅞	11½	8⅞	6	3½
2nd Quarter			25⅞	17½	22	15⅞	16⅞	12½	10⅞	8¼	8¼	4¾
3rd Quarter			28⅞	22	21⅞	16⅞	17⅞	12¾	14⅞	8	7¼	6⅞
4th Quarter			27	14	26¼	18	17	10⅞	20⅞	13½	11⅞	6⅞

NOTE: Long-term obligations, redeemable preferred stock and dividends are not applicable for the disclosed periods.

(i) The number of shareholders of record on March 9, 1981 was approximately 1,300.

